

Message Text

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PRS-01 USIA-06 SP-02 AID-05 EB-07 NSC-05 CIEP-01

SS-15 STR-04 OMB-01 CEA-01 CIAE-00 COME-00 FRB-03

INR-07 NSAE-00 XMB-02 OPIC-03 LAB-04 SIL-01 /099 W

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P 120801Z MAY 75

FM AMEMBASSY MANILA

TO SECSTATE WASHDC PRIORITY 3251

INFO AMEMBASSY SEOUL PRIORITY

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USADB

FOR NAC AGENCIES

E.O. 11652: ADS, DECLAS 12/31/75

TAGS: EAID, EFIN

SUBJECT: PROPOSED ADB LOAN FOR MACHINERY MANUFACTURING
PROJECT (KOREA)

SUMMARY: ADB MANAGEMENT PROPOSES \$17.5 MILLION
EQUIVALENT LOAN FROM ORDINARY CAPITAL RESOURCES TO
KOREA DEVELOPMENT BANK (KDB) TO FINANCE FOREX COST
OF CONSTRUCTING AND EQUIPPING NEW MACHINERY
MANUFACTURING PLANT OF HYUNDAI CQERNATIOCL, INC.,
(HII) AT GUNPO NEAR SEOUL. FUNDS WILL BE RELENT TO
HII UNDER GOVERNMENT GUARANTEE. USADB RECOMMENDS
FAVORABLE NAC ACTION.

1. ADB DOC. R43-75 WITH ATTACHMENTS DESCRIBING
PROPOSED LOAN POUCHED ADDRESSEES MAY 7. BOARD
CONSIDERATION SCHEDULED MAY 27.

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2. ADB MANAGEMENT PROPOSING \$17.5 MILLION LOAN

FROM ORDINARY CAPITAL RESOURCES TO KDB FOR ON-LENDING TO HII. PROCEEDS WILL FINANCE FOREX COST OF IMPORTATION OF PRODUCTION MACHINERY AND EQUIPMENT AND SERVICES OF FOREIGN CONSULTANTS FOR ESTABLISHMENT OF INTEGRATED FACILITIES FOR DESIGN AND MANUFACTURING OF INDUSTRIAL AND CONSTRUCTION MACHINERY IN PLANT OF HYUNDAI INTERNATIONAL, INC., AT GUNPO (30KM. FROM SEOUL). PROPOSED TERMS ARE 15 YEAR AMORTIZATION INCLUDING 4 YEAR GRACE PERIOD, 8-3/4 PERCENT INTEREST. KDB TO BE BORROWER, HII THE SUB-BORROWER AND EXECUTING AGENCY, AND REPUBLIC OF KOREA THE GUARANTOR. KDB WILL ON-LEND PROCEEDS OF BANK LOAN TO HII AT 10-1/2 PERCENT WITH SAME TERMS AND GRACE PERIOD AS BANK LOAN TO KDB. THIS RATE IS SAME AS PRESENT RATE FOR SUB-LOAN FROM BANK'S CREDIT LINE TO KDB. FOREIGN EXCHANGE RISK WILL BE BORNE BY HII.

3. KOREA'S RAPIDLY EXPANDING INDUSTRIES HAVE HAD TO RELY HEAVILY ON IMPORTED MACHINERY DUE TO UNDERDEVELOPED DOMESTIC MACHINERY MANUFACTURING SECTOR. (SALES OF INDUSTRIAL MACHINERY HAVE INCREASED FROM \$54 MILLION IN 1967 TO \$430 MILLION IN 1974.) IN ITS THIRD FIVE-YEAR PLAN (1972-1976) AND LONG-TERM ECONOMIC TARGET (1972-1981), ROKG HAS GIVEN HIGH PRIORITY TO MANUFACTURE OF INDUSTRIAL MACHINERY AND EQUIPMENT. IN VIEW HII'S PAST PERFORMANCE, IT WAS CHOSEN BY GOVERNMENT AS SUITABLE VEHICLE TO CARRY OUT PROPOSED PROJECT.

4. ROKG FIRST REQUESTED BANK TO CONSIDER FINANCING PROJECT IN 1973. BANK'S FACT-FINDING MISSION TO KOREA IN JANUARY 1974 FOUND THAT PRODUCT MIX PROPOSED FOR MANUFACTURE NEEDED MODIFICATION TO BETTER MEET KOREAN ECONOMIC PRIORITIES. REVISED PROJECT PROPOSAL

WAS SUBMITTED TO BANK IN MAY 1974. BANK APPRAISAL MISSION, WHICH VISITED KOREA IN FIRST HALF OF DECEMBER 1974, CONFIRMED THAT PROJECT WAS WELL CONCEIVED AND SUITABLE FOR BANK FINANCING.

5. OBJECTIVE OF PROJECT IS TO PROVIDE KOREA WITH LIMITED OFFICIAL USE

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INITIAL BASE FOR DEVELOPMENT OF DOMESTIC INDUSTRIAL TECHNOLOGY AND SUPPLY OF INDUSTRIAL MACHINERY AND SPARE PARTS. PLANT WILL MANUFACTURE MOBILE CRANES (25 TO 55 TONS CAPACITY), INDUSTRIAL AND AIR CONDITIONING CHILLERS (27 TO 855 REFRIGERATION TONS CAPACITY), LATHES AND MILLING MACHINES, TEXTILE SPINNING MACHINERY, CEMENT MAKING MACHINERY, PAPER MAKING MACHINERY, IRON CASTINGS, STEEL CASTINGS AND STEEL

FORGINGS AND MISCELLANEOUS FABRICATED PARTS AND EQUIPMENT.

6. PART A OF PROJECT, WHICH HII IS PROCEEDING TO IMPLEMENT USING ITS OWN RESOURCES AND LOCAL BORROWINGS FROM KDB, CONSISTS OF (A) ACQUISITION AND DEVELOPMENT OF PLANT SITE; (B) DESIGN AND CONSTRUCTION OF POWER SUBSTATION, WATER SUPPLY AND SEWERAGE SYSTEMS AND INTERNAL ROADS; (C) DESIGN AND CONSTRUCTION OF CAST IRON FOUNDRY, PATTERN, FORGING, CHILLER AND CRANE SHOPS AND MAIN OFFICE BUILDING; (D) PROCUREMENT AND INSTALLATION OF MACHINERY, EQUIPMENT AND ACCESSORIES FOR (C) ABOVE EXCEPT CRANE SHOP AND MAIN OFFICE BUILDING; (E) ACQUISITION OF NECESSARY TECHNICAL LICENSES; (F) RECRUITMENT OF TECHNICAL EXPERTS FROM CRANE AND CHILLER LICENSORS; (G) TRAINING OF HII ENGINEER AT CRANE AND CHILLER LICENSORS' PLANTS. PART B, FOR WHICH BANK PROPOSES TO FINANCE FOREIGN CURRENCY COMPONENT, INVOLVES (A) ACQUISITION OF ADDITIONAL TRANSFORMER AND CONTROL FACILITIES FOR POWER SUBSTATION; (B) CONSTRUCTION OF 1-1/2 KM. LENGTH OF RAILWAY SPUR; (C) DESIGN AND CONSTRUCTION OF STEEL FOUNDRY, FORGING SHOP

EXTENSION, WAREHOUSE, LIGHT MACHINERY SHOP COMPLEX, HEAT TREATMENT SHOP, TOOL AND DIE SHOP, HEAVY MACHINERY COMPLEX, AUXILIARY SHOPS AND BUILDINGS AND DORMITORY; (D) PROCUREMENT AND INSTALLATION OF NECESSARY MACHINERY, EQUIPMENT AND ACCESSORIES TO EQUIP (C) ABOVE; (E) RECRUITMENT OF TECHNICAL EXPERTS FROM LICENSORS; (F) RECRUITMENT OF TECHNICAL CONSULTANTS FOR PROJECT LIMITED OFFICIAL USE

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IMPLEMENTATION; AND (G) TRAINING OF HII'S ENGINEERS, TECHNICIANS AND SKILLED WORKERS AT LICENSORS' PLANTS.

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INFO OCT-01 EA-06 ISO-00 NEA-09 IO-10 L-02 H-02 PA-01

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7. TOTAL PROJECT COST IS ESTIMATED AT \$33.1 MILLION EQUIVALENT, OF WHICH ABOUT \$3.2 MILLION IS FOR PART A AND ABOUT \$29.9 MILLION FOR PART B. FOREX COMPONENT OF PART B AMOUNTING TO \$17.5 MILLION, WHICH BANK PROPOSES TO FINANCE, COVERS IMPORTATION OF PRODUCTION MACHINERY AND EQUIPMENT (\$17.1 MILLION) AND SERVICES OF FOREIGN CONSULTANTS (\$400,000). LOCAL CURRENCY COMPONENT OF ABOUT \$12.4 MILLION, WHICH HII WOULD FINANCE FROM INTERNAL RESOURCES AND BORROWING FROM KDB AND OTHER FINANCIAL INSTITUTIONS, CONSISTS OF \$8.0 MILLION FOR WORKING CAPITAL AND \$4.4 MILLION FOR BUILDING CONSTRUCTION, UTILITIES, TRAINING EXPENSES, SERVICE OF LICENSORS' EXPERTS, CONSULTANT SERVICES AND LOCAL HANDLING AND TRANSPORTATION CHARGES FOR IMPORTED MACHINERY. ANY ADDITIONAL FUNDS NEEDED FOR PROJECT WILL BE MADE AVAILABLE BY HII/KDB. AVAILABILITY OF SUCH FUNDS IS GUARANTEED BY ROKG. (SEE GUARANTEE AGREEMENT, SECTION 3.06.)

8. HII WOULD CARRY OUT PROCUREMENT UNDER SUPER-LIMITED OFFICIAL USE

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VISION OF KDB. PROCUREMENT CONTRACTS OF GOODS EXCEEDING \$100,000 TO BE AWARDED ON BASIS OF INTERNATIONAL COMPETITIVE BIDDING; CONTRACTS OF LESS THAN \$100,000 TO BE ON BASIS OF INTERNATIONAL SHOPPING. CONSULTANTS FOR ABOUT 84 MAN-MONTHS ARE TO BE RECRUITED TO SET UP WORKABLE SYSTEMS OF MACHINE DESIGN, QUALITY CONTROL, PRODUCTION CONTROL AND ASSEMBLY AND TO PROVIDE

EXPERT ADVICE ON CRITICAL MANUFACTURING AREAS OF JIG AND FIXTURE DESIGN, TOOL AND DIE DESIGN, HEAT TREATMENT AND METALLURGICAL ENGINEERING. ALSO, ONE PROCUREMENT CONSULTANT IN MACHINE TOOLS AND PRODUCTION ENGINEERING TO BE UTILIZED TO ASSIST IN TECHNICAL EVALUATION OF BIDS.

9. BORROWER (KDB) HAS ALREADY RECEIVED THREE CREDIT LINES FROM BANK TOTALING \$60 MILLION. IT IS CONSIDERED TO HAVE TECHNICAL EXPERIENCE AND CAPACITY TO PROPERLY SUPERVISE PROJECT IMPLEMENTATION AND HAS FINANCIAL RESOURCES TO PROVIDE LOCAL CURRENCY NEEDS OF PROJECT.

10. HII (SUB-BORROWER AND EXECUTING AGENCY) WAS ESTABLISHED IN 1962 AS JOINT STOCK COMPANY. IT IS AFFILIATE OF HYUNDAI GROUP AND IS INVOLVED IN SHIPPING AND MANUFACTURING. AT PRESENT, 50.1 PERCENT OF HII'S SHARES ARE OWNED BY ITS PRESIDENT; 44.2 PERCENT ARE OWNED BY HYUNDAI CONSTRUCTION CO., WHICH ITSELF IS OWNED SOLELY BY HII PRESIDENT'S FAMILY; 4.9 PERCENT ARE OWNED BY PRESIDENT'S RELATIVES; REMAINING 0.8 PERCENT ARE OWNED BY TWO FORMER HII DIRECTORS. HOWEVER, HII HAS AGREED TO BE CONVERTED INTO A PUBLIC COMPANY, AND BANK HAS RECEIVED ASSURANCES TO THIS EFFECT. TIME SCHEDULE AND TERMS OF GOING PUBLIC WILL BE AGREED WITH BANK. CONVERSION IS EXPECTED TO BE IMPLEMENTED BY JUNE 1979. (SEE SIDE LETTER NO. 4, PARA. 7, AND GUARANTEE AGREEMENT, SECTION 3.08). IT HAS ALSO BEEN AGREED (SIDE LETTER NO. 4, PARA. 6) THAT HII'S ACCOUNTS WILL BE AUDITED BY EXTERNAL AUDITING FIRM IN ANTICIPATION OF FUTURE LISTING ON KOREA STOCK EXCHANGE.

11. IN IMPLEMENTING THIS COMPLEX PROJECT, HII HAS LIMITED OFFICIAL USE

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SET UP MONITORING SYSTEM TO FACILITATE COORDINATION OF OPERATIONS. SERVICES OF CONSULTANTS WILL BE UTILIZED IN PROJECT IMPLEMENTATION. HII WILL ORGANIZE PROJECT IMPLEMENTATION TEAM OF APPROPRIATE COMPETENT TECHNICAL AND ADMINISTRATIVE PERSONNEL. BANK MISSION HAS INTERVIEWED ALL TEAM MEMBERS AND IS SATISFIED WITH THEIR QUALIFICATIONS AND CAPACITIES. HII WILL IMPROVE ITS ORGANIZATIONAL STRUCTURE AND DEVELOP MODERN MANAGEMENT TECHNIQUES BY SENDING PROFESSIONAL STAFF TO COMPANIES ABROAD FOR EDUCATION. TO INSURE SOUND FINANCIAL OPERATIONS, HII HAS GIVEN ASSURANCES TO MAINTAIN DEBT/EQUITY RATION OF NOT MORE THAN 70/30 AND CURRENT RATION OF NOT LESS THAN 1.2. IT WILL NOT PAY CASH DIVIDENDS IF CURRENT RATIO

(AFTER DIVIDEND PAYMENT) WOULD FALL BELOW 1.5 AND DEBT SERVICE COVERAGE WOULD FALL BELOW 1.5 TIMES. (SEE PROJECT AGREEMENT, SECTION 2.13(A) (I) AND (II).)

12. BANK WILL CONDUCT PERIODIC FIELD REVIEWS TO MONITOR PROGRESS OF PROJECT IMPLEMENTATION. HII WILL FURNISH (A) QUARTERLY PROGRESS REPORTS UNTIL COMPLETION; (B) QUARTERLY REPORTS ON OPERATIONS AND SEMI-ANNUAL REPORTS ON FINANCIAL STATUS UNTIL PROJECT REACHES BREAK-EVEN POINT; AND (C) ANNUAL AUDITED REPORTS ON COMMERCIAL OPERATIONS AND FINANCIAL STATUS UNTIL BANK LOAN IS COMPLETELY REPAID. PROJECT IS EXPECTED TO INCUR LOSSES DURING FIRST THREE YEARS OF OPERATIONS (1975-1977) DUE TO INSUFFICIENT REVENUE GENERATION. HOWEVER, ACCUMULATED LOSSES OF \$2.3 MILLION ARE EXPECTED TO BE COMPLETELY OFFSET BY EARNINGS IN 1978, WITH NET PROFIT AFTER TAX GRADUALLY INCREASING THEREAFTER. FINANCIAL RATE OF RETURN IS CALCULATED TO BE 17.3 PERCENT ON AFTER TAX BASIS AND ECONOMIC RATE OF RETURN AT 17.2 PERCENT.

13. WHEN PROPOSED PROJECT WAS FIRST LISTED IN MONTHLY OPERATIONAL INFORMATION IN JUNE 1973, NAC AGENCIES QUESTIONED WHETHER IT MIGHT NOT BE SUITABLE FOR FINANCING BY BILATERAL EXPORT CREDIT AGENCIES. USADB'S RESPONSE NOTED THAT PROJECT WAS PILOT ATTEMPT TO PRODUCE LOCALLY CERTAIN EQUIPMENT CURRENTLY IMPORTED LIMITED OFFICIAL USE

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BY KOREA AND THAT VENTURE WAS CONSIDERED TO BE OF CONSIDERABLY HIGH RISK. IN THIS REGARD, IT MIGHT BE NOTED THAT BOTH FINANCIAL AND ECONOMIC RATES OF RETURN ARE VERY SENSITIVE TO INCREASES IN PRODUCTION COSTS, WHICH WILL REQUIRE CAREFUL CONTROL TO MAINTAIN ECONOMIC VIABILITY OF PROJECT. AT TIME OF PROJECT APPRAISAL, BANK MISSION EXPLORED AVAILABILITY OF ALTERNATIVE SOURCES OF FINANCING WITH REPRESENTATIVES OF SEVERAL AGENCIES AND BANKS STATIONED IN SEOUL AND CONFIRMED THAT (A) THEIR PRIORITIES LIE IN AGRICULTURE, INFRASTRUCTURE AND SOCIALLY-ORIENTED PROJECTS; (B) THEIR AGGREGATE AMOUNTS AVAILABLE FOR THESE PROJECTS ARE RATHER LIMITED; (C) THEIR TERMS ARE TOO SHORT FOR THIS PROJECT; AND (D) WITH EXCEPTION OF KREDITANSTALT FUR WIEDERAUFBAU, THEIR PROCUREMENT IS TIED.

14. USADB STAFF HAS KEPT IN CLOSE TOUCH WITH BANK STAFF SINCE PROJECT PROPOSAL FIRST SURFACED. PROJECT ENGINEER HAS ESTIMATED THAT POSSIBLE SOURCES OF PROCUREMENT UNDER PROJECT, GIVEN VARIOUS SPECIALIZED CATEGORIES OF MACHINERY AND EQUIPMENT, ARE AS FOLLOWS: JAPAN 30

PERCENT, UNITED STATES 25 PERCENT, UNITED KINGDOM 20
PERCENT AND OTHERS 25 PERCENT. USADB WOULD APPRECIATE
SEOUL'S COMMENTS ON ABOVE ESTIMATE.

15. BY UTILIZING LOCAL MATERIALS, LOCALLY MANU-
FACTURED PARTS, ENGINEERING AND SKILLED MANPOWER,
PROPOSED PROJECT WILL ASSIST KOREA IN EFFORTS TO
ACHIEVE IMPORT SUBSTITUTION AND MORE BALANCED
DEVELOPMENT OF INDUSTRY. IT IS EXPECTED TO ACHIEVE
NET FOREX SAVING OF \$250 MILLION DURING 12.5 YEAR
ECONOMIC LIFE OF PROJECT; PROVIDE DIRECT EMPLOYMENT
FOR ABOUT 2700 PERSONS; HAVE SIGNIFICANT IMPACT ON
INDIRECT JOB CREATION; AND PROVIDE TECHNICAL KNOW-HOW
FOR KOREAN PERSONNEL. WITH HII'S ORGANIZATIONAL AND
MANAGEMENT COMPETENCE AND KDB'S TECHNICAL EXPERIENCE
AND FINANCIAL RESOURCES, BANK CONSIDERS PROJECT O
BE TECHNICALLY SOUND, FINANCIALLY VIABLE AND
ECONOMICALLY JUSTIFIABLE. USADB SUPPORTS PROPOSAL
AND RECOMMENDS FAVORABLE NAC ACTION.

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16. REQUEST SEOUL' COMMENTS FOR NAC AGENCIES, INFO
USADB MANILA, PURSUANT TO STATE 119795 DATED 3 JULY
1972.
SULLIVAN

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Draft Date: 12 MAY 1975
Decaption Date: 01 JAN 1960
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Disposition Approved on Date:
Disposition Authority: GolinoFR
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